

FINAL STATEMENT OF REASONS

To Promulgate New Sections 2581.1, 2581.2, 2581.3, and 2581.4, Article 17.2 of Subchapter 3,
Chapter 5, Title 10
California Code of Regulations: Actuarial Confidentiality and Conflict of Interest

INTRODUCTION

Section 10236.12 of the California Insurance Code requires the Commissioner to promulgate regulations ensuring that independent actuaries retained by the Department to review and certify long-term care insurance rate filings maintain the confidentiality of the long-term care rate filings and avoid conflicts of interest. These professional standards are set forth in CCR sections 2581.2 and 2581.3.

TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDY, REPORTS OR DOCUMENTS

The Commissioner did not rely upon any special technical, theoretical, or empirical studies, reports or documents as a basis for proposing adoption of these regulations.

ALTERNATIVES TO THE PROPOSED REGULATORY ACTION THAT WOULD LESSEN ANY ADVERSE IMPACT ON AFFECTED PRIVATE PERSONS OR SMALL BUSINESSES

No alternatives were considered which would be more effective in carrying out the purpose of the proposed regulations or would be as effective and less burdensome to affected private persons or small businesses than the proposed regulations.

SECTION 2581.1 PURPOSE

Public Problem, Administrative Requirement, or Other Condition or Circumstance that the Regulation Is Intended to Address

Proposed section 2581.1 explains the purpose of proposed sections 2581.1, 2581.2, 2581.3, and 2581.4.

Specific Purpose of the Regulation

The purpose of proposed section 2581.1 is to comply with the mandate of California Insurance Code Section 10236.12.

Necessity

Proposed section 2581.1 is necessary because it will clarify the purpose of the proposed regulation sections 2581.2, 2581.3 and 2581.4.

SECTION 2581.2: MAINTENANCE OF CONFIDENTIALITY

Public Problem, Administrative Requirement, or Other Condition or Circumstance that the Regulation Is Intended to Address

Section 10236.11 of the California Insurance Code requires that all policies for long-term care insurance be filed with, and approved by, the California Insurance Commissioner before such policies may be used in California. Section 10236.12 allows the Commissioner to contract with independent actuaries to review and certify these long-term care insurance rate filings if Department of Insurance actuaries do not have 5 years relevant experience in long-term care insurance industry pricing, or the Department does not have enough experienced actuaries to review the volume of long-term care insurance filings. Proposed Section 2581.2 will ensure that these outside actuaries maintain the confidentiality of the information obtained in the course of examining long-term care insurance rate filings.

Specific Purpose of the Regulation

The purpose of proposed section 2581.2 is to comply with the mandate of California Insurance Code Section 10236.12.

Necessity

Proposed section 2581.2 is necessary because it is mandated by statute. It will ensure that independent outside actuaries hired by the Department pursuant to California Insurance Code Section 10236.12 will maintain the confidentiality of the information obtained in the course of examining long-term care insurance rate filings.

SECTION 2581.3 AVOIDANCE OF CONFLICT OF INTEREST

Public Problem, Administrative Requirement, or Other Condition or Circumstance that the Regulation Is Intended to Address

Section 10236.11 of the California Insurance Code requires that all policies for long-term care insurance be filed with, and approved by, the California Insurance Commissioner before such policies may be used in California. Section 10236.12 allows the Commissioner to contract with independent actuaries to review and certify these long-term care insurance rate filings if Department of Insurance actuaries do not have 5 years relevant experience in long-term care insurance industry pricing, or the Department does not have enough of such experienced actuaries to review the volume of long-term care insurance rate filings.

Proposed Section 2581.3 will ensure that these independent outside actuaries avoid and disclose conflicts of interest with their review.

Specific Purpose of the Regulation

The purpose of proposed section 2581.3 is to comply with the mandate of California Insurance Code Section 10236.12.

Necessity

Proposed section 2581.3 is necessary because it is mandated by statute. It will ensure that independent actuaries hired by the Department pursuant to California Insurance Code Section 10236.12 to review and certify long-term care insurance rates avoid and disclose conflicts of interest with their review.

SECTION 2581.4: BILLING FOR ACTUARIAL SERVICES

Public Problem, Administrative Requirement, or Other Condition or Circumstance that the Regulation Is Intended to Address

No specific law exists in the California Insurance Code regarding the requisite filing fees for long-term care insurance rates under SB 898, rates which will be reviewed and certified by outside actuaries for the Department of Insurance. Proposed CCR Section 2581.4 would clarify the billing procedure for these actuaries' services.

Specific Purpose of the Regulation

The purpose of proposed section 2581.4 is to comply with the mandate of California Insurance Code Section 10236.12. It will clarify the billing procedure for outside actuarial services

Necessity

Proposed section 2581.3 is necessary because it will clarify the billing procedure for review and certification of long-term care insurance rates by outside actuaries.

PUBLIC COMMENTS ON THE PROPOSED REGULATIONS

I. American Academy of Actuaries

A. COMMENT: With respect to Section 2581.3, it might be simpler for the Department of Insurance to require independent actuaries, who are retained by the Department to examine long-term care insurance rate filings, to be members of the American Academy of Actuaries and thus subject to the American Academy of Actuaries' Code of Professional Conduct.

RESPONSE: California Insurance Code Section 10236.12 already requires outside actuaries, who are retained by the Department of Insurance to review and certify long-term care insurance rate filings, to be members of the American Academy of Actuaries. Section 10236.12 further requires that the Department promulgate regulations regarding confidentiality and conflicts of interest specific to review and certification of long-term care insurance rates. However, to more closely mirror the American Academy of Actuaries' Code of Professional Conduct, the Department has amended the regulations to require the examining actuary to disclose any financial interests in the company being examined rather than prohibiting such interests. See comment II-C below.

B. COMMENT: The American Academy's Code of Professional Conduct has replaced the concept of "direct user" with "principal," which is defined as the actuary's client or employer.

Response: In Section 2581.3, the phrase "direct user" has been replaced with "clients or employers of the actuary's services."

II. Association of California Life & Health Insurance Companies (“ACLHIC”)

A. COMMENT: We suggest the addition of the following wording to subsection (2) of proposed Section 2591.2:

“The actuary shall disclose to another party, and shall protect from unauthorized use, all confidential information obtained from the California Department of Insurance *or the company* in the course of examining long-term care insurance rate filings.”

RESPONSE: Section 2591.2, subsection (1), states that:

“The actuary shall not disclose to another party, other than the California Department of Insurance, and shall protect from unauthorized use, any confidential information obtained in the course of examining long-term care insurance rate filings, unless authorized to do so by the company or required by law...”

This subsection includes confidential information obtained from the company. Therefore, an additional requirement is unnecessary.

B. COMMENT: Section 2581.3(1)(c) allows another company to veto a filing company’s rate review simply because the objecting company used the actuary’s services once before. We suggest the following language:

“All such known users of the actuary’s services have had the opportunity to present a basis for an actual conflict of interest if the actuary were to examine long-term care insurance rate filings.”

California Insurance Code Section 10236.12 requires outside actuaries who are retained by the Department to review and certify long-term care insurance rate filings to be members of the American Academy of Actuaries. The American Academy of Actuaries Code of Professional Conduct, Precepts 7(b) and (c), require that an actuary disclose any actual or potential conflicts of interest with “all present and known prospective” clients or employers whose interests would be effected by the conflict and requires that the clients or employers expressly agree to the services by the actuary.

Proposed Section 2581.3(1)(c) follows the American Association of Actuaries Code of Ethics which is already imposed on actuaries pursuant to CIC Section 10236.12. However, the Department has amended proposed Section 2581.3(1)(c) to more closely resemble Precepts 7(b) and (c) by replacing the phrase “known clients or employers” in Section 2581.3(1)(c) with “present, and known prospective, clients or employers.”

C. COMMENT: While proposed Section 2581.3(3) is well-intentioned, the prohibition would preclude anyone who invests in a mutual fund or any other small financial interest from being retained as an actuary for the Department. We propose the following language:

“If the actuary has a financial interest in the company filing the long-term care insurance rates, the actuary’s financial interest shall not represent a material share of the actuary’s assets. The actuary shall disclose to the Commissioner any material financial interest, such as direct ownership of stock, or other relationship the actuary has with the company filing the long-term insurance rates.”

Response: The Department agrees with comment II-C. Section 2581.3(3) has been amended to read:

3. The actuary *has disclosed* ~~owns no stock or has any other~~ financial interest in the company filing the long-term care insurance rates.

D. COMMENT: California Insurance Code Sections 733(g) and 736, do not authorize the Department to require insurance companies to pay the costs and expenses of all examinations by independent actuaries of long-term care insurance rate filings. According to the NAIC Financial Examiner’s Handbook, CIC Sections 733(g) and 736 relate only to financial examinations. These examinations are conducted as part of the Department’s regular monitoring of an insurer’s solvency, and do not apply to rate filing or policy form approvals. Additionally, The Department may not have authority under the Administrative Procedures Act to promulgate proposed Section 2581.4. ACLHIC would help the Department secure funding through “other statutory or budgetary channels.”

Response: California Insurance Code Section (“CIC”) 730(b) allows the Commissioner to conduct examination of admitted insurers as often as is appropriate, but minimally every five years. The nature, scope, and frequency of the examinations must be based on financial statement analysis and ratios, changes in management or ownership, actuarial opinions, reports of individual certified public accountants, and other criteria set forth in the NAIC Examiner’s Handbook.

CIC Section 733(g) allows the Commissioner to retain attorneys, appraisers, independent actuaries, independent certified public accountants, or other professionals and specialists as examiners, to carry out examinations. The cost of examinations are born by the company subject to the examination. Additionally, CIC Section 736 requires that all examinations be at the expense of the insurer.

The NAIC Examiner’s Handbook is organized into two sections: Part I covers financial examinations; and Part II covers market conduct examinations, including rate review. Indeed, the Introduction to Part II states that “The non-financial regulatory activities performed by an insurance department include not only market conduct examinations, but producer licensing, policy form approval, *rate regulation*, compliance activities, consumer education, cost containment and consumer complaint processing.” (*Emphasis Added.*)

Pursuant to CIC Sections 730(b), 733 and 736, the Department regularly conducts market conduct examinations of insurance companies, which include review of a company’s rates. The Department charges for these examinations pursuant to CIC Sections 733 and 736.

Under CIC Section 10236.11, the Department is required to certify that an insurer's long-term care insurance rates are sufficient for the life of the policy without a rate increase, a complex process, essentially equivalent to a focused market conduct examination. No other feasible alternative exists for covering the costs of this examination by outside actuaries. The long-term care rate filing fee of \$130 or \$170¹ does not cover these costs, which based on quotes received from qualified actuaries in the private sector, could be up to \$4,000 per filing.

The Department could find no provision in the Administrative Procedures Act that would prohibit proposed Section 2581.4. Senate Bill 898 does not address the billing procedure for outside actuaries, and proposed Section 2581.4 clarifies this ambiguity.

After revising the regulation, as indicated above, the Department gave notice of the changes and offered 15 days for public comments. That notice was scheduled to go out on November 30, 2001, but because of an inadvertent mailing error went out on December 3, 2001, giving interested parties only 14 days for comments. Thus, the Department posted an extension of the time to comment, originally December 17, 2001, to December 18, 2001 on its Web site. No comments were received during this comment period.

¹ CCR Title 10, Subchapter 2, Article 1, Section 2202, promulgated prior to SB 898.